Speaker:

Hon. Cecelia G. Morris
U.S. Bankruptcy Judge, Southern District of New York
Poughkeepsie Division

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Subcommittee on Commercial and Administrative Law
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THE HON. CECELIA G. MORRIS

United States Bankruptcy Judge
Southern District of New York, Poughkeepsie Division

The Hon. Cecelia G. Morris was appointed United States Bankruptcy Judge for the Southern District of New York and took the bench on July 1, 2000. Judge Morris is a graduate of West Texas State University, and received her J.D. degree from John Marshall Law School.

Prior to her appointment to the bench, Judge Morris served as an Assistant District Attorney in the Child Support Recovery Unit of the District Attorney's Office of the Spalding Judicial District headquartered in Griffin, Georgia. Judge Morris also worked in private practice and served as Clerk of the Court for the United States Bankruptcy Court for the Southern District of New York from 1988 to 2000, the first bankruptcy court to implement electronic filing of original documents via the Internet.

With jurisdiction over six counties in New York's Hudson Valley, Judge Morris presides over a large consumer base. Judge Morris is often required to interpret the bankruptcy amendments added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and decide important consumer issues as matters of first impression in the Southern District of New York and the Second Circuit. In the past two years, Judge Morris has lead efforts by attorneys representing debtors and secured creditors to implement a model chapter 13 plan and model chapter 13 order. She pioneered a detailed worksheet that requires explanation of standing, arrearages and other current mortgage information as part of a motion for relief from the automatic stay concerning residential real estate and cooperative apartments. She recently collaborated with other judges and practitioners to develop the Loss Mitigation Program Procedures for the United States Bankruptcy Court for the Southern District of New York, the first court-supervised program in the U.S. to address voluntary modification of home loans.

Judge Morris is a frequent writer and lecturer on issues related to bankruptcy. Judge Morris is the author of several articles on electronic filing, including the chapter on electronic case filing in *Collier on Bankruptcy*, and has also published articles on mediation, the consumer credit counseling requirement in bankruptcy, and cross-border insolvency cases under Chapter 15 of the Bankruptcy Code. Judge Morris teaches Bankruptcy Ethics at St. John's University's LL.M in Bankruptcy program.

Judge Morris is presently a member of the Administrative Office of the U.S. Courts Bankruptcy Judges Advisory Group, and serves on various other committees to the Second Circuit, the Administrative Office, and to the National Conference of Bankruptcy Judges.

I am testifying today on my own behalf, and my views do not reflect the views of the Judicial Conference of the United States, the National Conference of Bankruptcy Judges, or any committee on which I serve.

Frances Fredericks, the courtroom deputy for the Poughkeepsie Division court, always prepares the court for session. One day, as she was turning on the electronic recording equipment, posting the court's agenda, and preparing the bench for the day, people begin to file into the courtroom. She noted five women in turbans. She came back into chambers to let me know that, "it is going to be a tough day." She knew that each of those five women had a story, and each of their stories was going to include something about their individual cancer treatments. The men and women who hobbled in that day were in difficult positions. Most of the stories included the loss of a job due to the inability to work because of the chronic illness or injury. They lost their health insurance. They can't afford gap insurance. They used credit cards to pay bills, they cannot live without their doctors, prescriptions, food or shelter.

It is well documented that around half of all bankruptcies are the result of a serious medical problem.[1] As little as twenty years ago, the aftermath of serious medical problems accounted for less than ten percent of all bankruptcies.[2] There have been a number of changes in the last twenty years including increase in health costs, surging number of un-insured and underinsured Americans, and significant changes to the Bankruptcy Code.[3] This written material seeks to briefly lay out a bankruptcy judge's perspective on the impact of serious medical conditions on bankruptcy, comment on the text of H.R. 901, and demonstrate a connection between H.R. 901 and the Loss Mitigation Program in the Southern District of New York.

There are at least two opposing schools of thought when it comes to the effect of medical debts on bankruptcy filings; that the correlation is overstated, versus serious medical problems are the largest contributing factor to bankruptcy filings. I believe that

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[1] David U. Himmelstein et al., *Illness and Injury as Contributors to Bankruptcy*, HEALTH AFF. WEB EXCLUSIVE W5-66 exhibit 1 (2005); *See also* Testimony of Prof. Elizabeth Warren before the House Judicial Committee July 17, 2007; *Also* David Himmelstein, Deborah Thorne, Elizabeth Warren and Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, HEALTH AFFAIRS (February 2, 2005).

[2] Teresa A. Sullivan, Elizabeth Warren, and Jay L. Westbrook, *The Fragile Middle Class: Americans in Debt* (Yale University Press 2000).

[3] David Himmelstein, Deborah Thorne, Elizabeth Warren and Steffie Woolhandler, *Medical Bankruptcy in the United States, 2007: Results of a National Study*, AMERICAN JOURNAL OF MEDICINE (2009).

the effect of serious medical problems on bankruptcy has been understated in academic research largely because medical debt is pervasive and often disguised as other types of debt including credit card debt, mortgage debt, or judicial judgments.[4] My ten years on the bench as a bankruptcy judge in a largely consumer court has shown that debtors will do anything to pay medical bills for themselves, their spouse, children, or member of their household. Their need for care outstrips any financial caution.

The preamble of proposed H.R. 901 states a desire to "provide protection for medical debt homeowners, to restore bankruptcy protections for individuals experiencing economic distress as caregivers … and to exempt from means testing debtors whose financial problems were caused by serious medical problems." It is my belief that H.R. 901 moves in the right direction to address the devastating impact of serious medical problems, and more needs to be done to alleviate the burden on debtors experiencing such events. An important first step is to exempt medically stressed debtors and caregivers from the means test, which is appropriate considering the Congressional intent behind the means test. The means test was enacted to address perceived abuses in chapter 7 bankruptcies, and was not meant to apply to medically stressed debtors who did not make a choice to go into debt as a result of medical catastrophes.[5]

The Southern District of New York Bankruptcy Court's Loss Mitigation Program has been an illuminating tool in my understanding of the effect of medical problems on bankruptcy. The Loss Mitigation program, which will be explained in greater detail, opens up the lines of communication between debtors and their secured creditors to discuss possible loan modifications. As part of the program, there are numerous and regular status conferences before the Court. Although these status conferences are time consuming, the Court learns an enormous amount of information that was not previously available to the Court. The Court hears why income levels have been reduced (sick spouse) or why they will increase (the death of a child means there is no longer a need for round the clock supervision) and more commonly why the debtor missed so many

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[4] *See e.g.* Aparna Mathur, Statement before the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, "Medical Debt: Is Our Healthcare System Bankrupting America." July 28, 2009.

[5] The Bankruptcy Code has various other tools to address debtor abuse including exception to discharge in 11 U.S.C. § 523, avoidance of fraudulent transfers under 11 U.S.C. § 548, and preference actions under 11 U.S.C. § 547.

months of mortgage payments (lost job due to injury). The program has been invaluable in illuminating the Court's perspective on the day to day needs of debtors.

Effect of Serious Medical Conditions on Bankruptcy

Health care costs are rising exponentially. In about twenty years, annual health care expenditures in the United States rose from $714 billion to over $2.3 trillion.[6] In 2008, health care spending was about $7,681 per resident, which accounted for 16.2% of the gross domestic product.[7] Real median household income has risen slightly in the last twenty years from about $48,000 to $50,303.[8] During the same time period, the number of uninsured individual has risen from 35 million to 46.3 million.[9] How are individuals paying for the increasing burden of medical costs while their income remains stagnant? My experience in the courtroom points to the different solutions employed by debtors in order to shoulder this burden including: spending down bank accounts, using credit cards to pay for medical care or other necessary expenses, emptying out retirement accounts and taking out second and third mortgages on their real property.

A 2008 National Household Survey of credit card debt among low-income and middle-income households showed that income has been stagnant or decreasing while the cost of living expenses increased.[10] A 2007 study showed that 40 percent of all individuals filing for bankruptcy had lost income due to illness and that nearly 35 percent had medical bills in excess of $5,000 per year or at least ten percent of their annual family income.[11]

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[6] Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, National Health Care Expenditures Data, January 2010.

[7] Anderson, G.F., B.K. Frogner. November 2008, Health Spending in OECD Countries: Obtaining Value per Dollar. *HEALTH AFFAIRS* 27(6):1718-1727; See also http://www.kaiseredu.org.

[8] U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2008 (September 2009) at 7. http://www.census.gov/prod/2009pubs/p60-236.pdf.

[9] U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2008 (September 2009) at 29. http://www.census.gov/prod/2009pubs/p60-236.pdf.

[10] Jose Garcia and Tamara Draut, The Plastic Safety Net, How Households are Coping in a Fragile Economy, Demos (July 28, 2009). http://www.demos.org/pubs/psn_7_28_09.pdf.

[11] David Himmelstein, Deborah Thorne, Elizabeth Warren and Steffie Woolhandler, *Medical Bankruptcy in the United States, 2007: Results of a National Study*, AMERICAN JOURNAL OF MEDICINE (2009) at 3.

My experience on the bench illuminates this phenomenon. An example that comes to mind is of a debtor whose wife was dying of breast cancer. This debtor was lucky. He was employed with an internationally known firm and had excellent insurance. His wife was no longer able to financially contribute to the household, so the burden was shifted entirely to him. Co-payments and co-insurance stretched his already tight budget. The debtor had to pay his wife's doctor because she needed a continuation of care. First the debtor tapped all the equity in his home to pay for these expenses and then began to makes charges on his credit card to pay for taxi fare to and from the doctor's office, since he could not leave work to take his wife. Apart from the majority of costs that were covered by medical insurance, there were numerous supportive care expenses including hot water bottles, humidifiers and other things not covered by insurance. My experience has shown me that debtors will do anything to ease pain and suffering, especially when the medical care is for a loved one. This includes the use of those very convenient blank checks sent by credit card companies in the mail. Generally, the debtors need cash to pay for at least some expenses and these checks become a double edged sword. After a debtor files for bankruptcy, the credit card companies that issue these checks file adversary proceedings to except the debt from discharge, alleging that the debtors used them fraudulently or under false pretenses.

A quadruple jump in medical costs and stagnant income in the last twenty years has resulted in increased pressure on a growing number of debtors. The vast majority of individuals do everything in their power to pay medical expenses before they contemplate filing for bankruptcy. These individuals do not choose to get sick, injured or have a member of their household develop a serious illness. A countless number before me are debtors who have emptied out exempt retirement accounts, taken out a second mortgage or increased their first mortgage, borrowed from friends and family members, and sold cars or personal property all to pay medical expenses. These individuals find themselves in a situation where they genuinely want to work but cannot because they have a serious medical condition, are paying for a relative with a serious medical condition, or are caring for a household member with a serious medical condition. Often times their work hours are reduced voluntarily or non-voluntarily as a function of their own physical needs or their commitments as caregivers.

Medical expenses often do not appear on the bankruptcy petition as medical debt. In the case where a debtor lost income as a result of caregiving functions or a medical condition, the reduced income would appear on the petition without explanation. The same is true of bank and retirement accounts wiped out to pay for medical expenses; the reduced balance would appear on the petition without explanation. The same phenomenon is present for a second mortgage that was taken for the purpose of paying medical expenses.

11 U.S.C. § 707(b)(2), known as the means test, establishes a presumption of abuse for certain chapter 7 debtors. The means test, put into place by the 2005 amendment to the Bankruptcy Code, looks at the debtor's current monthly income and allowable expenses and creates a presumption bad faith when the number is above a certain amount. Under 11 U.S.C. § 707(b)(2)(B)(i) this presumption of abuse can only be rebutted under special circumstances such as a serious medical condition or call to active duty. H.R. 901 would allow economically distressed caregivers and medically distressed debtors to defeat a presumption of abuse.

<u>Analysis of H.R. 901</u>

Under H.R. 901, once a debtor has established that he or she is a medically distressed debtor, they would then qualify for at least two benefits. The property exemptions outlined in 11 U.S.C. § 522 would now include section (r), which would exempt the debtor's aggregate interest up to $250,000 in personal or real property that the debtor or a dependent of the debtor uses as a residence or burial plot. 11 U.S.C. § 522(r) would allow debtors to opt out of less generous state exemptions and opt for the $250,000 exemption. Although this is a very positive development for debtors with significant equity in their property, this level of equity in a residence is increasingly rare. In my example above about the debtor with a wife dying of breast cancer, he attempted to meet her medical needs despite being hopelessly under water each month by tapping the equity in his home. That particular debtor had insurance coverage for his wife, and if she had been un-insured he would have exhausted the equity in his home at a much greater speed. The equity in their residence is generally exhausted before filing for bankruptcy.

H.R. 901 also seeks to create a class of debtors who are economically distressed caregivers. These individuals receive a work reduction or loss of work as a result of care for a relative for at least 30 days. Economically distressed caregivers and medically distressed debtors would be immune from motions to dismiss founded on the presumption of abuse under the means test.

There is a practical problem of implementation, namely what type of notification and documentation will the debtor need to provide in order to qualify for this exemption? This creates a privacy issue. Should the Bankruptcy Code require a debtor to put potentially confidential medical information on the Electronic Case Filing System? Section 107 of the Bankruptcy Code states that information filed in a bankruptcy are "public records and open to examination by any entity at reasonable times without charge." Who would be able to challenge the assertion that the debtor fails to rebut the presumption that the debtor filed in bad faith? Would those entities then be entitled to review the medical documentation?

<u>Loss Mitigation Program</u>

The status conferences of the Loss Mitigation Program are a window for the Court to see what causes debtors to file for bankruptcy. The Loss Mitigation Program went into effect January 5, 2009, in the Bankruptcy Court for the Southern District of New York, which has jurisdiction over New York, Bronx, Westchester, Rockland, Orange, Dutchess, Ulster and Sullivan counties, and concurrent jurisdiction over Greene and Columbia counties in New York. Loss Mitigation must be requested by the debtor or the creditor and is not mandatory upon the filing of a bankruptcy case.

Although lenders cannot be compelled to agree to loan modifications and bankruptcy judges are barred from modifying first mortgage on primary residences, lenders can be required to enter into discussions with borrowers. When foreclosure proceedings are under way in state court, some homeowners seek bankruptcy protection. The United States Bankruptcy Code allows homeowners to propose their own plan for repaying missed mortgage payments over as long as a five-year period, while paying current mortgage payments as they come due. The amounts needed each month to rehabilitate a mortgage are too much for some seriously ill homeowners or caregivers to afford, and as currently drafted, the Bankruptcy Code does not permit debtors to reduce or modify mortgages on real property used as their principal residence as they could for most other types of mortgages and liens. This means that homeowners who don't have the income to catch up on their mortgage will soon find themselves back in foreclosure proceedings, unless they can reach agreement with their lenders. This is when the Loss Mitigation Program is made available to the parties.

The Bankruptcy Court's Loss Mitigation Program opens the lines of communication in two significant ways. First, it requires the lender to disclose direct contact information for a person with full authority to make a decision. Second, it provides that the lenders will not be liable for violating the automatic stay if they participate in loss mitigation discussions with a homeowner in bankruptcy. In other aspects, the Bankruptcy Court's Loss Mitigation Program is similar to court-sponsored mediation programs,[12] which encourages the parties to settle their own disputes where the cost and risks of litigation would be too much for one or both parties to bear. The idea behind the Loss Mitigation Program is a simple one – to identify the decision makers for both the debtor and the lender, to prescribe a period for them to meet and discuss a consensual solution, and to provide a uniform set of guidelines and judicial oversight. Debtors benefit from having an identified contact who has authority to negotiate and bind the lender to the resulting agreement, what information they must supply, and how to submit it and make payments. The regularly scheduled status conferences provide the Court with a dramatic window into the financial life of a debtor over an extended period of time. One particular debtor filed her request for Loss Mitigation on Jan. 20, 2009. After a more than a year of adjournments, loss mitigation was finally terminated on the record of the hearing on April 27, 2010. The debtor's husband was dying of cancer, and the bank couldn't wait anymore. The chapter 13 trustee's motion to dismiss was granted on July 1, 2010, and the case was closed. Debtor remains liable for her credit card debt and is vulnerable to legal action by her creditors.

[12] *See* Civil Justice Reform Act, 28 U.S.C. §§ 471-482 (1990).

Conclusion

H.R. 901 is a beginning in helping debtors who are financially distressed due to chronic illness or injury to rehabilitate their balance sheets to be able to provide for their loved ones. The Court's Loss Mitigation Program has provided a window into the daily financial lives of debtors with serious medical conditions or those who provide care to loved ones. The situation is more serious than academic research suggests and Congressional action is necessary in order to ease the burden on these well intentioned debtors who are burdened by unforeseen events. The application of the Means Test to medically distressed debtors and caregivers is contrary to Congressional intent to curb perceived abuse, and H.R. 901 corrects this injustice.